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INFO RUCNIAD/IGAD COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC 0063

UNCLAS SECTION 01 OF 03 ADDIS ABABA 002561

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STATE FOR AF/E, AF/EPS, AND EB/TRA

E.O. 12958: N/A
TAGS: ECON ETRD EINV EAGR EAIR ET

SUBJECT: ETHIOPIA MONTHLY ECONOMIC REVIEW FOR JULY 2007

REF: ADDIS ABABA 2324 (AND PRIOR)

ADDIS ABAB 00002561 001.2 OF 003

¶1. SUMMARY.
--FEDERAL BUDGET: The Ethiopian Parliament unanimously approved a USD 4.9 billion budget for fiscal year 2007/08. The budget is Ethiopia's highest, representing a 24 percent increase over the 2005/06 budget, and a 44 percent increase over 2004/2005. The defense budget officially rose for the first time in three years by 16.7 percent, while subsidies to regional states increased by over 44 percent. To finance the budget, the GOE announced two tax increases, affecting small-to-medium enterprises and rental income.

--The consumer price index (CPI) is still on the rise; CPI inflation reached 17.8 percent in July.
--The official exchange rate of the Ethiopian Birr against the U.S. dollar continued to slowly depreciate, reaching 9.0326 Birr/USD at the end of July.
--Ethiopia's trade deficit widened further in 2006/07. The fuel import bill reached USD 890 million in 2006/07 and is projected to reach USD 1.2 billion for 2007/08 (equal to total export receipts).
--Commercial banks are adjusting their interest rate structure in line with the recent directives issued by Ethiopia's central bank, the National Bank of Ethiopia (NBE).
--Ethiopian Airlines (EAL) and Gulf Air entered into a code sharing agreement. EAL has also signed an agreement to purchase MD-11 freighter aircraft from Boeing.
--The Chinese Road and Bridge Corporation won the majority of road projects tendered recently in Ethiopia.
END SUMMARY.

BUDGET AND FINANCE

¶2. Ethiopia's parliament approved a proposed budget of USD 4.9 billion for fiscal year 2007/08. For the first time in sixteen years, the budget was approved unanimously. The budget was 24 percent higher than the 2005/2006 budget (USD 4.05 billion) and 44 percent higher than 2004/05 (USD 3.4 billion).   The budget consists of a USD 2.1 billion capital budget, a USD 1.2 billion recurrent budget, and USD 1.6 billion in subsidies to Ethiopia's regional states. Over 40 percent of the budget is planned for pro-poor sectors such as agriculture, irrigation and water resource development, road construction, education, health, and rural electrification services. The defense budget officially rose for the first time in three years by 16.7 percent. Prime Minister Meles defended the defense budget increase in parliament by saying "The increase now aims at strengthening the country's military capability, as a deterrent against anyone who may try to threaten the country's territorial integrity."   Subsidies to regional states increased by over 44 percent, showing the government's commitment to

expand services at the grassroots level.

¶3. Nearly 58 percent of the budget is expected to be financed from domestic revenue, in contrast to 41 percent last year. The increase in coverage from domestic revenue is mainly due to improved tax administration, a broadening tax base, and the recently levied surtax. Some 25 percent comes from external assistance, and 17 percent from domestic and external loans. Given the prevailing double digit inflation, the real rate of growth in the annual budget is only 4 percent, indicating a prudent fiscal stance. Generally, opposition parties and donors welcome the budget.

¶4. The Ministry of Finance and Economic Development (MOFED) issued two directives aimed at broadening the tax base of the country and raising government revenue. The profit tax directive raises category C presumptive tax rates at the regional level from 7.5-10 percent to 10-30 percent. (NOTE: Category C businesses are those whose annual turnover is below USD 11,000. END NOTE.) Tax on rental income was increased from 10 to 30 percent. The directive was distributed to local tax collecting agencies in Ethiopia's nine regional states, as well as Addis Ababa and Dire Dawa. Some local business owners oppose these directives, aimed at raising funds to cover the record high federal budget. The tax bases were significantly revised downwards in the aftermath of May 2005 national elections, in response to complaints from taxpayers.

INFLATION, EXCHANGE RATES AND INTEREST RATES

¶5. The annualized country level headline inflation rate has been steadily rising and reached 17.8 percent in June 2007, in contrast to 17.3 percent in the preceding month and 12.3 percent a year earlier. The GOE has been distributing subsidized wheat in Addis Ababa since February 2007 to curb the rise in inflation. Ethiopia's central bank, the National Bank of Ethiopia (NBE), has also raised the minimum bank deposit rate by 1 percent, and raised the reserve requirement ratio from 5 to 10 percent to reinforce the effort to abate inflation.

ADDIS ABAB 00002561 002.2 OF 003

¶6. The official exchange rate of the Ethiopian Birr is determined by the daily inter-bank foreign exchange market in which the NBE intervenes to regulate the market. The inter-bank rate at the end of July reached 9.0326 Birr/USD in contrast to 9.0296 Birr/USD at the end of June. Meanwhile, the parallel market rate at private shops in different parts of Addis declined to 9.25 Birr from 9.30 Birr last month. The Birr in the parallel market will further appreciate as more remittances are expected for the Millennium celebration. (NOTE: According to the Ethiopian calendar, the year 2000 arrives September 11, 2007. END NOTE). Driven by rising domestic inflation relative to prices of Ethiopia's major trading partners, the real effective exchange rate is appreciating, making the country's exports less competitive.

¶7. The central bank allowed the lending interest rate to be determined by market forces in January 1998, but continues to control the floor deposit rate. The minimum deposit rate, previously fixed at 3 percent per annum, was revised to 4 percent effective July 4, 2007. Consequently, commercial banks have raised their lending rates by one percent. Given the double digit inflation rate, however, real interest rates are currently negative. The Bank also raised the legal reserve requirement ratio of commercial banks from 5 to 10 percent effective July 20. The central bank has rejected the Bankers Association's request for a three-month grace period to comply with the revised reserve requirement ratio.

EXPORTS, IMPORTS AND BALANCE OF TRADE

¶8. Total receipts secured from exports of merchandise during the just-concluded Ethiopian fiscal year reached USD 1.2 billion, reflecting an 11 percent increase over the previous fiscal year, but a 21 percent shortfall from the GOE's projected USD 1.5 billion. Of the total dollar amount, coffee accounted for 36 percent, oil seeds

16 percent, gold 8 percent, khat 8 percent, and leather and leather products 7.6 percent. On the other hand, the total import bill rose to USD 5.1 billion--over 18 percent more than last year, leading to a widening gap in the trade deficit.

¶9. According to the Ethiopian Petroleum Enterprise's (EPE) latest data, Ethiopia's fuel import bills in FY 2006/07 year reached USD 890 million, a 19 percent increase from the preceding year. About 1.6 billion liters of fuel were imported, indicating an average price per liter of USD 0.55. The supply of jet fuel and kerosene saw an 11 percent increase, while benzene consumption showed 10 percent growth. Fuel oil consumption has remained nearly at last year's level. The projection for 2007/08 spending of fuel imports is USD 1.2 billion (1.8 billion liters), 34 percent higher than 2006/07.

¶10. Berki International, a Saudi-based oil company, clinched the supply contract for the first half of FY2007/08, outbidding four other companies, including U.S.-based oil company Exxon Mobil, which had been supplying the country's major fuel imports for the last three years.

AVIATION AND ROADS

¶11. State-run Ethiopian Airlines (EAL) and Gulf Air, the national carrier for the Kingdom of Bahrain, have entered into a strategic code sharing agreement, which will enable the two airlines to open up routes and service to each other in their respective networks and provide customers with seamless connections between their networks. While EAL has various cooperation agreements with other African and European carriers, this accord is the first with a Gulf region carrier.

¶12. EAL also signed an agreement with Boeing Capital Corporation (BCC) to purchase one MD-11 freighter aircraft for delivery in December 2008. The MD-11, currently in a passenger configuration, will soon be converted to a freighter with an 88-ton cargo capacity. Ethiopian is also negotiating for a second converted MD-11 freighter aircraft on a lease basis, scheduled for delivery at the end of 2009. Ethiopian now owns and operates two B757 freighter aircraft.

¶13. The Chinese Road and Bridge Corporation (CRBC) clinched two-thirds of the Addis Ababa City Road Authority's (AACRA) road projects, valued at more than USD100 million. The firm outbid local and foreign rivals in five of the nine road projects, whose designs had been undertaken a year earlier by local designers. In addition to CRBC, another Chinese firm, UE Industrial, has also won one of the projects. According to the city's latest road project contracts

signed in July 2007, the CRBC will construct four segments of asphalt roads stretching a total of 20 kilometers and forty meters wide. The construction is expected to be completed in two years.

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